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C O N F I D E N T I A L CARACAS 001501

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TAGS: ECON EFIN PGOV VE
SUBJECT: BANKS FACE INTEREST RATE CONTROLS

REF: A. CARACAS 806
¶B. CARACAS 288

Classified By: ACTING DCM RICHARD M. SANDERS FOR REASON 1.4 D

SUMMARY

¶1. (C) On April 28, the Venezuelan Central Bank published new regulations capping the interest rates at which Venezuelan banks can lend money, as well as setting minimum interest rates for both savings accounts and time deposits, effective May 1. Embassy economic contacts agree that while this will cut into bank profits, it will not have a particularly harmful short-term effect, and is essentially a political decision. However, this is yet one more way in which the GOV is attempting to control the economy. END SUMMARY.

AT THIS RATE...

¶2. (SBU) The Venezuelan Central Bank (BCV) published new requirements on April 28 for lending and savings rates at Venezuelan banks. The new rates were effective on May 1, just one full business day after the publication. The new maximum lending rate was set to 28%, or 0.5% below the re-discount rate (rate at which BCV lends to banks when loans exceed available cash). The minimum rate for deposits was set at 6.5%, which is 5% less than the "28-day absorption" rate (the interest rate paid by the BCV to combat inflation by reducing liquidity). Time deposits also received a minimum rate of 10%, or 1.5% less than the "28-day absorption" rate. In addition, several commissions previously collected by banks were eliminated. On May 3 the BCV published an additional regulation which limited additional interest on overdue loans to 3% more than the original rate. The last time the GOV fixed any such rates was from June 1995-April 1996, but only for temporary employee investment accounts and mortgages indexed to inflation. Cristina Rodriguez, president of economic consultancy Metroeconomica, told econoff May 6 that rate fixing was common up until 1989, though less extensively than is the case with the new regulations.

THE NEW BOTTOM LINE

¶3. (SBU) It appears this decision will have little immediate effect on the rate paid on time deposits, which presently average 11.2%, though some 30-day rates will increase. Savings rates will rise more, from their current 4.8% average, but they represent only 19% of all deposits. Credit cards, while representing only 9.9% of the total lending portfolio, will be affected more, as current rates are generally above 40%. Miguel Octavio, President of BBO Financial Services, noted in an April 29 newsletter that "blue chip banks like Citibank and Banco Venezolano de Credito were paying savings rates near 2% and will be strongly affected by the new regulation." He also opined, "The new regulations will likely push up lending rates for good corporate risks," while Alejandro Grisanti, president of consultancy Ecoanalitica, wrote in a May 3 newsletter that banks will probably soon be "increasing the interest rates the banks collect from the big corporations and businesses."

¶4. (C) Overall, Rodriguez predicted "not much impact" on banks, since "the margins are pretty wide," though she noted that the BCV can easily adjust them in the future, now that the precedent has been set. Jesus Bianco, chief economist of the National Banking Association, told econoff May 4 that these controls, in effect for a full year, would reduce banks' return on equity by 7%, based both on actual 2004 numbers and 2005 projections. He noted that it would affect different banks in different ways, commenting that "the asymmetries are brutal." Others agreed, but Rodriguez predicted worse effects for the big banks, which will have to adjust their rates farther, while Luis Zambrano, chief

economic analyst for Banco Mercantil, told econoff May 4 that "small banks are less efficient, and will suffer more from this measure." Bianco, however, said that if inflation were to increase much, the net worth of banks could be placed at risk.

THE WHYS AND THE WHEREFORES

¶5. (C) Rodriguez believes that the rate increase was "more of a political action" than economic, while Rafael Munoz, a Banco Mercantil economist, said the GOV's entire economic policy is "only political, in our judgment." Grisanti thinks the key is "the political dividend, that from these measures the President of the Republic could obtain the benefit." Octavio wrote that "perhaps its most negative aspect is the introduction of another form of control into an already over controlled economy." Rodriguez echoed that comment, stating that "the public sector is expanding, expanding, expanding its scope." She also expects this to be a lasting measure, as "politically, it's extremely hard to increase rates" after fixing them.

COMMENT

¶6. (C) GOV control over the financial sector continues to creep forward. Combined with previously existing requirements directing lending to housing, agriculture and microcredit, and setting caps on the mortgage an agriculture rates (ref A), 39% of all bank lending is either directed to certain areas, has controlled (preferential) rates, or both. That number is all but certain to increase soon, as the National Assembly recently approved a report which would require publicly owned banks to commit 10% of their portfolio to tourism, and private banks 20%. (A tourism requirement is probable in the near future, but it is unlikely for the final percentage to be that high.) Venezuela's banks have made a lot of money since the imposition of exchange controls, which has in effect given them a large base of depositors who cannot take their money out of the country and have had to accept low interest rates, even as the banks, given the risk factors, have set lending rates high. The GOV solution, however, represents yet another distortion built on other distortions, and entails long-term risk for the bulk of Venezuela's financial sector. The BCV is now giving high priority to populist economic ideas, making it appear that the new GOV supporters in its leadership (ref B) were enough to end the autonomy of the institution.
McFarland

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